

LOS ANGELES DEPARTMENT OF WATER AND POWER

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4-01-08
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**Report on Internal Control over Financial Reporting and on Compliance and
Other Matters Based on an Audit of Financial Statements Performed in Accordance
with Government Auditing Standards**

The Board of Water and Power Commissioners
Department of Water and Power
City of Los Angeles:

We have audited the financial statements of the City of Los Angeles' Department of Water and Power's Power Revenue Fund (Power System) and Water Revenue Fund (Water System), enterprise funds of the City of Los Angeles, California (the Department) as of and for the year ended June 30, 2007, and have issued our reports thereon dated November 14, 2007. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audits, we considered the Department's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Department's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Department's financial statements that is more than inconsequential will not be prevented or detected by the Department's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Department's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

This report is intended solely for the information and use of management, the Department's Board of Water and Power Commissioners, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

March 28, 2008, except as to
the schedules of expenditures
of federal awards, which are
as of November 14, 2007.

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Notes to Schedules of Expenditures of Federal Awards

June 30, 2007

(1) **General**

The accompanying schedules of expenditures of federal awards (SEFAs) present the activity of all federal financial assistance programs of the City of Los Angeles' Department of Water and Power's Power Revenue Fund (Power System) and Water Revenue Fund (Water System), enterprise funds of the City of Los Angeles, California (the Department). The reporting entity is defined in the notes to the Department's financial statements.

(2) **Basis of Accounting**

The accompanying schedules of expenditures of federal awards are presented using the accrual basis of accounting, as described in note 1 of the notes to the Department's financial statements. The information in these schedules are presented in accordance with the requirements of Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Nonprofit Organizations*.

(3) **Summary of Expenditures**

Total expenditures for the Department are summarized as follows:

<u>Grantor</u>	<u>Federal CFDA No.</u>	<u>Federal expenditures</u>
U.S. Department of Transportation (DOT):		
L.A. County Metropolitan Transportation Authority (Metro Rail)	20.500	\$ 906,058
U.S. Department of Homeland Security:		
Federal Emergency Management Agency (FEMA):		
Public Assistance Grant Program (PAGP)	97.036	952,213
Hazard Mitigation Grant Program (HMGP)	97.039	11,319,624
U.S. Environmental Protection Agency (EPA):		
Super Fund	66.802	472,484
State of California Department of Health Services	66.468	40,885,361
Pass through State of California Governor's Office of Homeland Security (OHS):		
Homeland Security Grant Program (HSGP) – Urban	97.008	629,660

LOS ANGELES DEPARTMENT OF WATER AND POWER

Schedule of Findings and Questioned Costs

June 30, 2007

(1) Summary of Auditors' Results

(a) Financial Statements

Type of auditors' report issued:

Water System – **Unqualified**

Power System – **Unqualified**

- Material weaknesses identified? **None noted.**
- Significant deficiencies identified that are not considered to be material weaknesses. **None reported.**

(b) Federal Awards

Internal control over major programs:

- Material weaknesses identified? **None noted.**
- Significant deficiencies identified that are not considered material weaknesses?

Water System – **Findings 2007-01, 2007-03**

Power System – **Findings 2007-01, 2007-02, 2007-04, 2007-05, 2007-06**

Type of auditors' report issued on compliance for major programs: **Unqualified opinion.**

Any audit findings disclosed that are required to be reported in accordance with Section 510 (a) of OMB Circular A-133? **Yes**

Water System – **Finding 2007-01**

Power System – **Findings 2007-01, 2007-02, 2007-04, 2007-05, 2007-06**

Identification of major programs:

<u>CFDA numbers</u>	<u>Name of federal program or cluster</u>
97.039 (Power System)	Hazard Mitigation Grant Program (HMGP)
97.036 (Power System)	Public Assistance Grant Programs (PAGP)
66.468 (Water System)	Capitalization Grants for Safe Drinking Water – State Revolving Funds

Dollar threshold used to distinguish between Type A and Type B program: **Water – \$1,316,117, Power – \$338,845**

Auditee qualified as a low-risk auditee under Section 530 of OMB Circular A-133? **No.**

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Schedule of Findings and Questioned Costs

June 30, 2007

(2) **Findings Relating to the Financial Statements Reported in Accordance with *Government Auditing Standards***

None noted.

(3) **Findings and Recommendations Relating to Federal Awards**

Finding 2007-01 – Lack of Internal Control to ensure compliance with Davis Bacon Act and Suspension and Debarment

Information on Federal Programs: U.S. Environmental Protection Agency: Passed through State of California Department of Health Services – CFDA number 66.468 (Water System), U.S. Department of Homeland Security – Federal Emergency Management Agency (FEMA) Passed Through State of California Governor's Office of Emergency Services (OES) – Hazard Mitigation Grant Program – CFDA number 97.039 (Power System) and Public Assistance Grant Program – CFDA number 97.036 (Power System). Federal award number is not applicable.

Specific Requirement: In its funding agreements with the State, the Department agreed to comply with all the requirements of the Office of Management and Budget Circular A-133 (OMB A-133).

Davis Bacon Act. According to OMB Circular A-133, when required by the Davis-Bacon Act, the Department of Labor's (DOL) government-wide implementation of the Davis-Bacon Act, or by Federal program legislation, all laborers and mechanics in excess of \$2,000 financed by Federal assistance funds must be paid wages not less than those established for the locality of the project (prevailing wage rates) by the DOL (40 USC 276a to 276a-7).

Non-federal entities shall include in their construction contracts subject to the Davis-Bacon Act a requirement that the contractor or subcontractor comply with the requirements of the Davis-Bacon Act and the DOL regulations (29 CFR part 5, "Labor Standards Provisions Applicable to Contracts Governing Federally Financed and Assisted Construction"). This includes a requirement for the contractor or subcontractor to submit to the non-Federal entity weekly, for each week in which any contract work is performed, a copy of the payroll and a statement of compliance.

Suspension and Debarment. According to OMB Circular A-102, Section .1.c(6), federal grantees are prohibited from contracting with or making subawards under covered transactions to parties that are suspended or debarred or whose principals are suspended or debarred.

Condition: Since projects usually start years before approval of funding agreements, single audit requirements have not been complied with as the expenditures are incurred. Upon application for funding, the Department has not implemented procedures to make sure it is compliant with the above-mentioned requirements of OMB A-133.

The Department has not implemented internal control procedures to verify on a regular basis if current contractors for the Safe Drinking Water Projects pay all their employees at or above the prevailing wage rates, as required by the Davis-Bacon Act. Currently, the Department only investigates the contractor's wage rates when a problem arises. Moreover, these periodic investigations have not necessarily related to the Davis-Bacon Act.

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June 30, 2007

With regard to the Suspension and Debarment requirement, although the Cost and Project Accounting group claims they are consistently verifying whether the vendors that the Department is contracting with are suspended or debarred by the federal government, they are unable to provide evidence that they performed this before applying for the loan program.

We also noted in our test work that the personnel managing the projects, are not knowledgeable or aware of such requirements partially because there is no effective communication between the different groups involved in the drafting of the funding agreements (i.e. Contracts Management), and accounting for expenditures reported in SEFA (i.e. Cost and Project Accounting), as to how federally-funded projects should be run and how OMB A-133 requirements are to be implemented.

Questioned costs: None

Systemic or Isolated: Systemic

Effect: The Department may be transacting with third party vendors/contractors that are in violation of the Davis-Bacon Act or are suspended or debarred.

Recommendation: We recommend a consistent and regular coordination between groups involved in implementation of single audit requirements, such that everyone is made aware and accountable for specific responsibilities. We also recommend that before funding agreements are drafted, Contracts Management coordinate with project managers and the Cost and Project Accounting group, to ensure that projects applied for are compliant with OMB A-133 requirements.

View of Officials and Planned Corrective Actions:

The Department's Cost and Project Accounting will coordinate closely with Project Management and Contracts Management involved with the Safe Drinking Water Projects to ensure compliance with the Davis-Bacon Act. In addition, Cost and Project Accounting will start documenting the verification of vendors' new purchase orders or contracts for projects funded by federal grants in compliance with the Suspension and Debarment requirement.

Finding 2007-02 – Lack of Sufficient Control over Review and Approval of Transportation and Equipment Charges

Information on Federal Programs: U.S. Department of Homeland Security – Federal Emergency Management Agency (FEMA) Passed Through State of California Governor's Office of Emergency Services (OES) – Hazard Mitigation Grant Program – CFDA number 97.039 (Power System). Federal award number is not applicable.

Specific Requirement: According to OMB Circular A-87, Attachment A, paragraph C, to be allowable under federal awards, costs must be authorized or not prohibited under state or local laws and regulations.

Condition: One out of forty tested transportation and equipment charges was not supported by properly reviewed and approved timesheets.

Questioned costs: \$998 (amount of equipment charge)

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Schedule of Findings and Questioned Costs

June 30, 2007

Systemic or Isolated: Systemic

Effect: The Department may be incorrectly charging transportation and equipment charges to programs funded by the federal government, overstating the expenditures reported in SEFA.

Recommendation: Supervisors designated to approve such charges should take note of the accuracy of hours charged. Moreover, timekeepers should verify if timesheets are properly approved before time charges are recorded in the payroll system.

View of Officials and Planned Corrective Actions:

The Department's Cost and Project Accounting will remind the Fleet Services Division to strictly follow the existing controls over issuance of transportation and equipment, which include proper review and approval.

Finding 2007-03 Lack of Internal Controls over Approval of Payment to Contractors

Information on Federal Programs: U.S. Environmental Protection Agency: Passed through State of California Department of Health Services Capitalization Grants for Safe Drinking Water State Revolving Fund Program – CFDA number 66.468 (Water System). Federal award number is not applicable.

Specific Requirement: According to A-87, Attachment A, paragraph C.1, to be allowable under Federal awards, costs must be authorized or not prohibited under State or local laws or regulations.

Condition: The Department does not have a formal system in place for assigning temporary authority when an authorized approver is not available, and his/her signature is needed. Currently, if a manager is absent, he/she will informally assign a temporary signatory. As this is an undocumented delegation, there is no audit trail to determine whether the Contractor's certificates and invoices are appropriately approved. We noted three contractor invoices out of 30 invoices tested that were signed and approved by an employee informally assigned with authority to approve.

Questioned costs: None

Systemic or Isolated: Systemic

Effect: The Department may inappropriately certify Contractor's certificates and invoices.

Recommendation: We recommend a formal system be set up to facilitate proper review and approval of payments to Contractors. If an authorized approver is not available to approve payments, we recommend a formal and documented system of assigning temporary authority.

View of Officials and Planned Corrective Actions:

The review and approval of payments to contractors will include a documented system of assigning temporary authority to contract administrators if an authorized approver is not available to approve payments.

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Schedule of Findings and Questioned Costs

June 30, 2007

Finding 2007-04 Lack of Internal Controls to ensure compliance with A-87 (Indirect Cost Proposals)

Information on Federal Programs: U.S. Department of Homeland Security – Federal Emergency Management Agency (FEMA) passed through State of California Office of Emergency Services (OES) – Hazard Mitigation Grant Program – CFDA number 97.039 (Power System) and Public Assistance Grant Programs – CFDA number 97.036 (Power System). Federal award number is not applicable.

Specific Requirement: According to A-87, all Departments or agencies of the governmental unit desiring to claim indirect costs under Federal awards must prepare an indirect cost rate proposal and related documentation to support those costs. These governmental units are not required to submit their proposals unless they are specifically requested to do so by the cognizant agency. The proposals must be developed within six months after the close of the governmental unit's fiscal year, unless an exception is approved by the cognizant agency.

Documentation of the proposal should include the following:

- a. The rates proposed, including subsidiary work sheets and other relevant data, cross referenced and reconciled to the appropriate financial data. Allocated central service costs will be supported by the summary table included in the approved central service cost allocation plan. This summary table is not required to be submitted with the indirect cost proposal if the central service cost allocation plan for the same fiscal year has been approved by the cognizant agency and is available to the funding agency.
- b. A copy of the financial data (financial statements, comprehensive annual financial report, executive budgets, accounting reports, etc.) upon which the rate is based. Adjustments resulting from the use of unaudited data will be recognized, where appropriate, by the Federal cognizant agency in a subsequent proposal.
- c. The approximate amount of direct base costs incurred under Federal awards. These costs should be broken out between salaries and wages and other direct costs.
- d. A chart showing the organizational structure of the agency during the period for which the proposal applies, along with a functional statement(s) noting the duties and/or responsibilities of all units that comprise the agency.
- e. Required certification that proposal was prepared in accordance with A-87.

Condition:

Although an organizational chart is available it was not included in the proposals. Moreover, the proposals were dated after the 6 month requirement for submission. Lastly, the required certification was not prepared.

Questioned costs: None

Systemic or Isolated: Systemic

Effect: The Department may not be able have their indirect costs reimbursed.

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Schedule of Findings and Questioned Costs

June 30, 2007

Recommendation: The Department should follow the guidelines set out by A-87.

View of Officials and Planned Corrective Actions:

The Department's Cost and Project Accounting will follow the documentation guidelines set out by A-87 for the future Compensatory Time-off (CTO) and Fringe Benefits Rates Proposal.

Finding 2007-05 – Lack of Supporting Computations for Rates Used for Transportation and Equipment Usage

Information on Federal Programs: U.S. Department of Homeland Security – Federal Emergency Management Agency (FEMA) - Passed through State of California Office of Emergency Services (OES) – Hazard Mitigation Grant Program – CFDA # 97.039 (Power System). Federal award number is not applicable.

Specific Requirement: According to A-87, Attachment A, paragraph C.1, to be allowable under Federal awards, costs must be authorized or not prohibited under State or local laws or regulations and are supported by appropriate documentation.

Condition: The Department could not provide supporting computations for the usage rates for two out of eight Transportation and Equipment expenses charged to the program.

Questioned costs: \$394 (amount of equipment charges)

Systemic or Isolated: Systemic

Effect: The Department may not be able have their costs reimbursed.

Recommendation: The Department should keep documents that support purchase prices and/or rental charges or any other support for usage rates used.

View of Officials and Planned Corrective Actions:

The Department's Cost and Project Accounting will remind the Fleet Services Division to maintain proper documentation supporting computations for rates used for transportation and equipment usage.

Finding 2007-06 – Expenditures in SEFA Incurred After Period of Availability

Information on Federal Programs: U.S. Department of Homeland Security – Federal Emergency Management Agency (FEMA) - Passed through State of California Office of Emergency Services (OES) – Public Assistance Grant Programs – CFDA #97.036 (Power System). Federal award number is not applicable.

Specific Requirement: According to A-102 Common Rule, where a funding period is specified, a non-Federal entity may charge to the award only costs resulting from obligations incurred during the funding period and any pre-award costs authorized by the Federal awarding agency.

Condition: The Department charged expenditures to the program that were beyond the approved project completion date for 14 out of 120 items tested.

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Schedule of Findings and Questioned Costs

June 30, 2007

Questioned costs: \$6,402 (amount of time charges and invoices beyond the approved completion date)

Systemic or Isolated: Systemic

Effect: The Department may not be able have their costs reimbursed.

Recommendation: The Department should request an extension of project completion deadlines from the granting agency before expenditures are incurred.

View of Officials and Planned Corrective Actions:

A request to extend the approved completion date for one project included in the 2005 February Storm is in the process for submission to the State of California Governor's Office of Emergency Services (OES).